STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

THE PEOPLE OF THE STATE OF ILLINOIS, *ex. rel.* LISA MADIGAN, Attorney General of the State of Illinois	)	
Complaint to suspend tariff changes submitted by Ameren Illinois and to investigate Ameren Illinois Rate MAPP pursuant to Sections 9-201, 9-250 and 16-108.5 of the Public Utilities Act	)	Docket No. 13-0501
	)	(cons.)
AMEREN ILLINOIS COMPANY d/b/a Ameren Illinois Revisions to its Formula Rate Structure and Protocols	)	Docket No. 13-0517

EXCEPTIONS AND BRIEF ON EXCEPTIONS OF

THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois

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I. INTRODUCTION

The People of the State of Illinois, by Attorney General Lisa Madigan ("AG" or the "People") submit the following Exceptions and Brief on Exceptions to address three formula rate tariff issues addressed in the Proposed Interim Order issued on November 1, 2013 (hereinafter "Int. Proposed Order"). The People take exception to the following three conclusions:

1. The Int. Proposed Order erroneously failed to recommend that the Commission correct Ameren Exhibit 2.4 to eliminate an unauthorized change to the Return on Equity (ROE) collar computation found on Schedule FR A-3 that occurred as a consequence of that schedule erroneously referring to an input on Schedule FR A-1 REC in calculating the collar.

2. In connection with the application of interest to the over- or under-collection of the reconciliation balance, the Int. Proposed Order failed to recommend that the Commission recognize the income tax effect on the utility's cash flow and only apply interest to the net-of-tax amount representing the amount of cash the utility actually has to finance during the reconciliation period. This change to the formula is necessary to apply interest to the *actual* under- or over-collections, is required by fundamental ratemaking principles, and is fully consistent with GAAP procedures and rules.

3. In connection with the Company's proposed modification to Schedule FR C-2 to implement an adjustment to its forecasted depreciation expense and the People's proposed modification thereof, the Int. Proposed Order erroneously accepted the Company's groundless contentions in its Reply Brief that (i) there was a mathematical order in the People's proposed change; (ii) the People should have contemplated depreciation adjustments not based on a study; and (iii) the People were required to make this proposal through an expert witness. Schedule FR C-2 and Workpaper 18 should be modified to be more transparent, as outlined in the People's Corrected Initial Brief.

III. EXCEPTIONS

A. The Commission Should Require the Use of Average Rate Base in the ROE Collar Calculation and Reject the Interim Proposed Order's Recommendation to Reject the People's Proposal on this Issue.

The Int. Proposed Order recommends that the Commission adopt the Company's position on the issue of the rate base to be used in the return on equity ("ROE") collar calculation in annual formula rate updates: the ALJs conclude that the Public Utilities Act, as amended by P.A.

98-0015, requires the use of year-end rate base, rather than average rate base, in the ROE collar calculation for a given reconciliation year. Int. Proposed Order at 12. The Int. Proposed Order supports this conclusion with a finding that "the overall intent of the General Assembly, as reflected in PA 98-0015, includes the use [of] year-end rate base to calculate the common equity balance for the purpose of determining the earned ROE for the collar calculation." *Id.* This conclusion is based on an inference of the General Assembly's legislative intent and should be rejected by the Commission. The structure of Section 16-108.5 of the Public Utilities Act ("PUA"), and the language of the 2013 amendments to that section found in P.A. 98-0015, demonstrate that the General Assembly *did not* intend for year-end rate base to be used in the ROE collar calculation.

The ROE collar calculation and the reconciliation revenue requirement calculation are designed to measure two different things. The ROE collar is designed to assure that the utility does not actually receive revenues, and earn profits, that differ by more than 50 basis points from the utility's authorized return on equity. This requires that the Commission determine the utility's actual net income, applicable rate base, and common equity ratio based on its year-end capital structure. AG Ex. 2.0 at 3:191-193. P.A. 98-0015 did not address the use of the average rate base or the Commission's prior conclusion that this approach accurately reflects the utility's actual cost of investment over the course of the year. Further, using average rate base in the ROE collar computation matches the net income used in the ROE calculation, which is the income earned over the course of the year, with the rate base as it existed during the course of the year. See AG Ex. 2.0 at 3-4. Consistent with Section 16-108.5(c)(2) and (5), the year-end capital structure, showing the percentages of rate base funded by debt and by equity, is used to establish the dollar value of common equity. Company witness Stafford admitted during cross-

examination that the term capital structure is used to refer to the "mix of debt or equity capital." AG Ex. 6.0 at 36 (Docket 13-0301 Tr. at 252:1-2). The Commission had used average *capital structure* in the ROE collar calculation in prior orders. See Docket No. 12-0001, Order at 110; Docket No. 12-0293, Order at 105-106.

While not addressing the rate base to be used in the ROE collar calculation, P.A. 98-0015 amended Section 16-108.5(d)(1) of the PUA to provide that the *reconciliation-year revenue requirement* be determined in annual formula rate updates using year-end rate base. Prior to the passage of the amendatory P.A. 98-0015, the Commission had concluded that it was more accurate to use average reconciliation year rate base in calculating the reconciliation-year ("RY") revenue requirement. See Docket No. 12-0001, Order at 174-175 (Sep. 19, 2012)(Ameren); Docket No. 11-0721, Order at 18-21 (May 29, 2012)(Commonwealth Edison).

The use of average rate base in the ROE collar calculation was not challenged by either Ameren or ComEd in prior Commission formula rate update dockets. Average rate base was used in the collar calculation through operation of Line 1 of Schedule FR A-3, which referred to the same rate base value used in the reconciliation ("RY") revenue requirement calculation. See, e.g., Docket No. 13-0301, AIC Ex. 1.1[1], Sch. FR A-3, Line 1 (importing the rate base from the RY revenue requirement calculation into the ROE collar calculation) and Sch. FR A-1 REC, Line 11 (using average rate base in the RY revenue requirement calculation). AG Ex. 2.0 at 5:241-242. While the formula rate expressly directed the use of average rate base in the ROE collar calculation, P.A. 98-0015 did not address how rate base should be calculated for purposes of the ROE collar.

Section 16-108.5(c)(5) of the PUA, prior to the passage of P.A. 98-0015, described the ROE collar and directed the Commission to calculate the ROE "using costs and capital structure

[1] The Company's Exhibit 1.1 from Docket No. 13-0301 pre-dated passage of P.A. 98-0015.

approved by the Commission as provided in" Section 16-108.5(c)(2). This section was not amended by P.A. 98-0015. However, its referent, Section 16-108.5(c)(2), *was* amended by P.A. 98-0015, now providing that the formula rate shall "[r]eflect the utility's actual ***year-end*** capital structure for the applicable calendar year" (emphasis indicating the amendment).

Although "capital structure" is not defined in the statute, Company witness Stafford, an expert in regulatory accounting according to his direct testimony (AIC Ex. 2.0, Appendix, pp. 1-2), stated during cross-examination that the term 'capital structure' is used to refer to a "mix of debt or equity capital." AG Ex. 6.0 at 36 (Docket 13-0301 Tr. at 252:1-2). The General Assembly's § 16-108.5(c)(2) command to use year-end capital structure throughout the formula means, consistent with the meaning recognized by Mr. Stafford, that the Company's mix of debt and equity in its capital structure at the end of the RY should be used, together with an authorized rate base value, to determine the Company's amount of investor equity upon a return is calculated.

As AG witness Effron stated in direct testimony, "the capital structure enters into the formula rate template only in the form of the capital structure ratios, and is therefore not relevant to the rate base to be used in the ROE collar computation." AG Ex. 1.0 at 6:151-153. The Commission has, in the past, distinguished between the two issues of (i) average vs. year-end capital structure, and (ii) average vs. year-end rate base. See, e.g., Docket No. 12-0001, Order at 106 (Sep. 19, 2012) (addressing a methodology for determining the Company's capital structure for purposes of the ROE collar calculation, with "capital structure" shown as the percentage mix of common equity, preferred stock, long-term debt, and short term debt). As recently as *People ex rel Madigan v. Illinois Commerce Commission*, 2011 IL App (1st) 100654, ¶ 5, 958 N.E. 2d 405, 408-409, the Court related Peoples Gas' and North Shore Gas' capital structure as the

percentage of common equity and debt used to determine the utility's rate of return. Further, in *Central Illinois Public Service v. Illinois Commerce Commission,* 243 Ill.App.3d 421,439-442, 610 N.E.2d 1356, 1369-1376 (1993) the Court included a comprehensive discussion of capital structure, discussing it exclusively as a mixture of financing, without reference to rate base.

Significantly, Section 16-108.5(c)(5) cross-references Section 16-108.5(c)(2) with regard to the *capital structure* to be used in the ROE collar calculation. However, Section 16-108.5(c)(5) contains no cross-reference to Section 16-108.5(d)(1) with regard to the *rate base* to be used in the ROE collar calculation. The equity used in the denominator of the ROE calculation is calculated by multiplying the relevant equity percentage from the capital structure by the applicable rate base, as shown on Line 6 of AIC Ex. 2.5, Sch. FR A-3. As discussed below and contrary to the Int. Proposal Order's conclusion, the General Assembly has not indicated any intention to change the average rate base used in the ROE collar calculation.

If the new "year-end capital structure" language found in Section 16-108.5(c)(2), as amended by P.A. 98-0015, is interpreted by itself to require the use of year-end *rate base* in the ROE collar calculation, then that same language alone should, logically, also require the use of year-end rate base in the RY revenue requirement calculation. However, the General Assembly saw fit in P.A. 98-0015 to insert amendatory language into Section 16-108.5(d)(1) expressly providing that year-end rate base should be used in computing the RY revenue requirement. If the amendatory "year-end capital structure" language in § 16-108.5(c)(2) alone mandates the use of year-end rate base in key formula rate calculations (RY revenue requirement and ROE collar), then the new "year-end rate base" language in § 16-108.5(d)(1) as amended by P.A. 98-0015 is unnecessary and superfluous.

While the General Assembly did not change the ROE collar section of the law (Section 16-108.5(c)(5)), or adopt a requirement to use year-end *rate base* in the ROE collar calculation, a statutory directive addressing how rate base should be calculated for the RY revenue requirement was adopted by the General Assembly. An elementary canon of statutory construction is to avoid interpretations that render any language in the statute superfluous. "A court presumes that the legislature intended that two or more statutes which relate to the same subject are to be read harmoniously so that no provisions are rendered inoperative." *Knolls Condominium Ass'n v. Harms*, 202 Ill.2d 450, 458-9 (2002). The General Assembly clearly added the amendatory "year-end rate base" language to § 16-108.5(d)(1) because it wanted to alter the rate base used in the RY revenue requirement calculation, recognizing that the amendatory "year-end capital structure" in § 16-108.5(c)(2) did *not* mandate the use of year-end rate base in the RY revenue requirement calculation. It follows that the "year-end capital structure" amendatory language also did not alter the rate base to be used in the ROE collar calculation. As discussed above, capital structure and rate base are two different concepts and the ROE collar calculation measures profitability-not the RY revenue requirement.

Moreover, the summary provision of P.A. 98-0015, subsection (k), provides at § 16-108.5(k)(3) that "[t]he tariff changes described in paragraphs (1) and (2) of this subsection (k) shall relate only to, and be consistent with, the following provisions of this amendatory Act of the 98th General Assembly: paragraph (2) of subsection (c) regarding year-end capital structure, subparagraph (D) of paragraph (4) of subsection (c) regarding pension assets, and subsection (d) regarding the reconciliation components related to year-end rate base and interest calculated at a rate equal to the utility's weighted average cost of capital." Subsection (d) relates to the calculation of the RY revenue requirement. It is apparent that subsection (k)(3), which purported

to capture all the amendatory tariff provisions of P.A. 98-0015, was completely silent about using year-end rate base in the ROE collar calculation.

When enacting P.A. 98-0015, the General Assembly can be assumed to be aware of the Commission's widely accepted use of average rate base for computing the ROE collar – but it did not address the issue. At the same time, it chose to expressly address the Commission's prior use of average rate base in computing the RY revenue requirement. Principles of statutory construction show that the failure to address an issue, when other issues are addressed, shows an intent to leave the issue unchanged. *People ex rel. Daley v. Grady,* 192 Ill.App.3d 330, 333, 548 N.E.2d 764, 766 (1st Dist. 1989). When an act lists things to which it refers, the court may infer that any omissions were intended as exclusions.[2] *Bank of Waukegan v. Kischer,* 246 Ill.App.3d 616, 620, 616 N.E. 624, 727 (2nd Dist. 1993); *Town of Normal v. Hafner,* 395 Ill.App.3d 589, 597, 918 N.E.2d 1268, 1274 (4th Dist. 2009) ("the expression of one thing in a provision generally excludes all others, even where there are no negative words of prohibition"). It is clear that the best interpretation of P.A. 98-0015 is that the General Assembly lacked the intent to change the rate base used in calculating the ROE collar. The Int. Proposed Order's conclusion to the contrary should not be adopted by the Commission.

Finally, the People support the conclusion at page 12 of the Int. Proposed Order that "[t]he Commission's decisions in Docket Nos. 12-0001 and 12-0293 reflect its belief that use of the average rate base most accurately reflects AIC's costs. The Commission continues to believe that use of the average rate base will produce a dollar balance that correctly represents the actual capital supplied by equity investors to support AIC's rate base over the course of the year for which the ROE is being calculated." As AG witness Effron stated in direct testimony, "[t]he net income used in the ROE calculation is the income earned over the course of the year, not the

[2] The hoary Latin phrase encapsulating this principle is "*expression unius est exclusio alterius*."

annualized net income being earned at the end of the year. To be consistent, the common equity balance used in the denominator of the ROE calculation should be the average balance of common equity over the course of the year." AG Ex. 2.0 at 3-4. While Ameren has complained that using average rate base in the ROE collar will decrease the nominal ROE in years in which rate base grows, the Commission should adopt an analysis that accurately reflects the return fairly realized by investors. Ameren's result-driven approach should be rejected.

Proposed Language:

Consistent with the arguments above, the People urge the Commission to modify the Int. Proposed Order's conclusion at page 12 as follows, as indicated by the following inserts that are underlined, and deletions, indicated by ~~strikethrough~~:

> How to calculate the ROE collar is certainly one of the more contested issues in this proceeding. The AG and AIC go to great length to explain their respective positions. The Commission's decisions in Docket Nos. 12-0001 and 12-0293 reflect its belief that use of the average rate base most accurately reflects AIC's costs. The Commission continues to believe that use of the average rate base will produce a dollar balance that correctly represents the actual capital supplied by equity investors to support AIC's rate base over the course of the year for which the ROE is being calculated. ~~Nevertheless, t~~The General Assembly has indicated through PA 98-0015 that it intends for year-end rate base to be used in determining ~~rates~~ the reconciliation-year revenue requirement, but~~. W~~while some ambiguity arguably exists when it comes to the ROE collar calculation, the Commission finds that the overall intent of the General Assembly, as reflected in PA 98-0015, does not include~~s~~ the use of year-end rate base to calculate the common equity balance for the purpose of determining the earned ROE for the collar calculation. The General Assembly could have chosen to expressly address the use of year-end rate base in the ROE collar calculation as it addressed the use of year-end rate base in the reconciliation-year revenue requirement, but it did not do so. Accordingly, the changes sought by the AG concerning the collar calculation will ~~not~~ be adopted and the revisions concerning this issue approved in

Docket No. 13-0385 ~~will stand~~ are reversed so that the ROE collar calculation uses average rate base. The Company is hereby ordered to modify Line 1 of its Schedule FR A-3 as proposed in Exhibit 1 to the People's Corrected Initial Brief.

B. The Commission Should Find That Applying Interest to the Net-of-Tax Reconciliation Balance Is Required by the Law's Reliance On Actual Data And Is Consistent With P.A. 98-0015.

Contrary to the conclusion of the Int. Proposed Order, the Commission should conclude that Section 16-108.5(d) of the PUA authorizes the application of interest to the actual amount that the utility needs to recover from consumers to match its previously-authorized revenue requirement with its actual revenue requirement for the reconciliation year. Interest is, fundamentally, compensation for the time value of money, and interest should only apply to the amount of cash the utility has financed between the time its originally-estimated formula revenue requirement was collected and when the balance to recover its actual revenue requirement is collected. It is important to note that consumers pay the Company's full income tax expense in the reconciliation revenue requirement, as shown on Line 19 of Schedule FR A-1 REC. The question raised here is whether they should pay interest on the income tax expense that is payable on reconciliation cash revenues included in the reconciliation revenue requirement given the fact that, unlike all other reconciliation year expenses, the tax expense will not be paid until the reconciliation revenues are actually received by the utility. If the utility is allowed to charge consumers interest on cash it has not yet paid to the taxing authorities, the utility will receive interest on money it did not pay and does not have to finance. Because the tax rate is approximately 41%, ignoring the tax effect requires consumers to pay interest on an amount that is 1.7 times the net cash flow that was foregone while the utility is waiting for the cash recovery of its actual revenue requirement." AG Ex. 1.0 at 6:268-272; at Ameren Ex. 2.5, Sch FR C-4,

Line 11 (1.7 Gross Revenue Conversion Factor). Ignoring the tax effect requires consumers to pay interest on a balance that is higher than the amount the utility has actually expended prior to the recovery of its actual revenue requirement. This is unfair to consumers and is inconsistent with the goal of the law to reflect *actual* costs.

The Int. Proposed Order relies on the Company and Staff argument that the General Assembly did not expressly address the tax effect in connection with interest on the reconciliation balance and therefore the Commission must ignore the substantial effect this has on the interest calculation. Int. Proposed Order at 26. In addition to the AG's arguments presented in the Int. Proposed Order at 12-17, the Commission should reject this conclusion because while P.A. 98-0015 could have addressed the question of the tax effect on reconciliation interest, it left that an open question. P.A. 98-0015 expressly referred to the Commission's prior formula rate orders, stating: "this amendatory Act of the 98th General Assembly preempts and supersedes any final Commission orders entered in Docket Nos. 11-0721, 12-0001, 12-0293, and 12-0321 to the extent inconsistent with the amendatory language added to subsections (c) and (d)." 220 ILCS 5/16-108.5(k). The amendment's drafters chose to limit the issues addressed by the law to the interest rate applicable to the "over- or under-collection indicated by such reconciliation." The drafters did not address how to define the over- or under-collection; that is, they did not address the effect of income taxes on the amount of money the utility will actually have to finance pending recovery of its *actual* revenue requirement. As stated above, it is unfair to expect consumers to pay interest on money that the utility has not yet paid out.

It is assumed that the General Assembly was specifically familiar with the orders cited in subsection (k) of P.A. 98-0015. However, the amendatory law does not address taxes associated with or "indicated by" the reconciliation. Courts would view this failure to address an issue as

implying that the status quo is not affected. In its Order in Docket 11-0721, the Commission declined to apply the reconciliation interest rate to the net-of-tax balance, noting that it believed that insufficient information was provided to apply the adjustment. The Commission said:

> The Commission declines to adopt this recommendation. ComEd contends that this recommendation does not provide ComEd with cash. AG/AARP provide little information establishing that this procedure is within generally accepted accounting procedures, or that it would be of benefit to ComEd or to ratepayers.

Docket 11-0721, Order at 167 (May 29, 2012). This conclusion was not an absolute rejection of the AG's position that interest should only apply to the net-of-tax amount the utility actually has to finance pending recovery of the actual reconciliation revenue requirement. Rather, the Commission "decline[d] to adopt" the recommendation due to, in large part, its view that AG "provide[d] little information establishing that this procedure is within generally accepted accounting procedures." In this docket, a complete record was developed showing that this adjustment is fully consistent with generally accepted accounting procedures and is necessary to protect consumers from paying interest on money that utility has not yet expended. The record that Commission noted was missing in Docket 11-0721 has been fully developed in this docket through direct and rebuttal testimony by the People's regulatory accounting experts. See AG Ex. 1.0 at 3-10; AG Ex. 2.0 at 6:260-10:340; AG Ex. 3.0 at 3-11; AG Ex. 4.0 at 7:176-12:276.

The General Assembly could have directed the Commission to apply the weighted average cost of capital as the interest rate to the entire reconciliation balance, but it did not. It referenced the order in Docket 11-0721, but did not direct the Commission to treat deferred taxes on the reconciliation balance one way or the other, despite a tentative order inviting a fuller record on the tax effect on the reconciliation over- or under-collection in the May 29, 2012 Order

quoted above. Moreover, as demonstrated in the AG's Initial and Reply Briefs,[3] the treatment of income taxes and the effect of deferred revenue recovery involve fundamental accounting and ratemaking principles that the Commission regularly applies.

The Commission recognized the need to consider the tax effects of timing differences (i.e. accumulated deferred taxes or ADIT) even in the absence of a specific direction in the statute in Docket 11-0721 at pages 59-60, where it stated in a slightly different context:

> It is true, as ComEd argues, that the **statutory provision** regarding what is to be included at this juncture in time, **does not mention ADIT**. (220 ILCS 5/16-108.5(c)(6)). However, the statute is silent altogether with regard to ADIT and with regard to many other items that all agree must be included in, or deducted from, rates. **If the Commission were to ignore ADIT on ComEd's plant investments, we would be ignoring basic accounting principles and appellate precedent.** (See, Ameren Illinois Co. v. Ill. Commerce Comm., 2012 IL. App. (4th) 100962 at 31, 2012 Ill. App. LEXIS 175 (4th Dist. 2012), determining, with regarding to an ADIT adjustment to Ameren's rate base, that Section 9-211 of the Public Utilities Act requires that rate base cannot exceed the investment value that a utility actually uses to provide utility services.).
>
> …
>
> One would expect that, after the General Assembly treated so many issues with specificity that it would have specifically excluded ADIT in the statute, if that were its intent. It did not.

Docket 11-0721, Order at 59-60 (May 29, 2012)(emphasis added). The effect of deferred income taxes is considered by all parties on many issues despite the absence of specific direction to consider ADIT or taxes in Section 16-108.5 of the PUA. This is consistent with the General Assembly's expectation that the Commission would continue to review costs for reasonableness and prudence and applicable Commission rules and practices. Section 16-108.5(d)(3), in the section addressing the annual review and reconciliation, authorizes the Commission:

> to enter upon a hearing concerning the prudence and reasonableness of the costs incurred by the utility to be recovered

[3] AG Corrected Initial Brief at 20-23; AG Reply Brief at 16-17.

> during the applicable rate year …. The Commission shall apply the same evidentiary standards, including but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility… as it would apply in a hearing to review a filing for a general increase in rates under Article IX of this Act.

220 ILCS 5/16-108.5(d)(3); see also *id*. at 16-108.5(c)(1) & (6). The recognition of the effect of deferred taxes is a well-established regulatory practice. Unlike the more unusual aspects of the law that the General Assembly directly addressed (e.g. the reconciliation rate base and the interest rate at the weighted average cost of capital), the drafters did not address the effect of taxes on the interest calculation. Accordingly, the Commission should not ignore this fundamental regulatory and accounting tax principle.

PROPOSED LANGUAGE:

The People recommend some minor edits to the description of their position in the Int. Proposed Order, as indicated by the following inserts that are <u>underlined</u>, and deletions, indicated by ~~strikethrough~~.

B. Reconciliation Interest Calculation

1. AG Position

> The AG states that a key difference between the formula rate process and traditional ratemaking is that the formula rate statute allows the utility to restate its revenue requirement using historical data from the prior year reported in the FERC Form 1. The AG notes that the historical revenue requirement for reconciliation purposes is determined using actual FERC Form 1 data, subject to Commission review, and is compared to the revenue requirement in effect during the historical year. The statute allows the utility to collect interest on the reconciled revenue requirement as follows:
>
> Any over-collection or under-collection indicated by such reconciliation shall be reflected as a

> credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior year, the charges for the applicable rate year. (Section 16-108.5(d)(1))

The AG notes the statute directs the Commission to allow interest on the over- and under-collections "indicated by such reconciliation;" and while the statute could have directed the Commission to apply interest to the full reconciliation balance, it only authorizes interest on the "over-collection or under-collection." The AG states this requires the Commission to determine the actual over- or under-collection, taking into consideration the cash flow effect of the formula rate process. The AG believes the Commission should apply interest to the utility's actual cash expense to conform to the legislative intent that the reconciliation reflects "the actual cost information for the applicable calendar year." The AG notes the utility pays income taxes on the revenues it receives, and the amount of taxes actually paid by the utility in a given calendar year depends on the revenues actually received. Thus, regardless of whether the reconciliation revenue requirement is larger or smaller than that in effect during the year, the determination of the actual cash over- or under-collection indicated by the reconciliation will be affected by the timing of the payment of the income tax expense.

The AG contends that the payment of income taxes in the year revenues are received by the utility has a substantial effect on the actual cash flow of the utility. In a situation where the utility has under-recovered its reconciled revenue requirement, which is the opposite of AIC's present circumstance, Mr. Effron testified that the non- payment of income taxes (because revenues are not yet received) reduces the cash needed to fund an under- or over-collection. The AG states that AIC witness Stafford confirmed that the AG's theory was correct on this issue. The AG asserts that a utility should not receive interest to

compensate it for the payment of taxes in 2012 when those taxes will not be paid until the utility receives the under-collected revenues in 2014.

The AG asserts that when the Commission applied the short term interest rate, which was 2.3% in 2011, the failure to adjust the over- or under-collection to account for the income tax effect was "relatively immaterial." However, with the substantial increase in the interest rate to equal the weighted average cost of capital ("WACC") (8.163% for AIC) now required under PA 98-0015, the AG suggests that accounting for the tax effect of the delay associated with the reconciliation has become significant. In AIC's pending annual formula rate docket, where the reconciliation results in an over-collection necessitating a credit to consumers, the AG's witness Brosch acknowledges ~~opines~~ that accounting for the timing of tax payments will reduce the credit to consumers in this docket, while in future years, if the reconciliation balance results in a charge, consumers will properly benefit when income tax deferrals are properly considered.

The need to apply the reconciliation interest to a net reconciliation balance was raised by the AG in Docket No. 11-0721, ComEd's first formula rate docket, where the Commission expressed concerns about the completeness of the record, and did not make a definitive ruling. In the instant docket, the AG suggests that a full record has been developed, demonstrating that it is necessary to account for the tax effect in determining the under- or over-collection indicated by the reconciliation that is subject to interest.

The AG notes that the formula rate law consistently recognizes and incorporates Commission authority to review costs and accounting treatment and to apply Commission rules and practices. For example, Section 16-108.5(d)(3) authorizes the Commission:

> to enter upon a hearing concerning the prudence and reasonableness of the costs incurred

> by the utility to be recovered during the applicable rate year …. The Commission shall apply the same evidentiary standards, including but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility… as it would apply in a hearing to review a filing for a general increase in rates under Article IX of this Act. (Section 16-108.5(d)(3))

The AG states that the recognition of the effect of deferred taxes is a well-established regulatory practice. For example, the AG notes that electric utilities must include a schedule of accumulated deferred income taxes ("ADIT") in rate case filings, and all jurisdictional amounts of recorded ADIT credit and debit balances are regularly included~~-~~ in rate base. In AIC's initial formula rate case, the AG notes that an adjustment to rate base was made to recognize the vacation reserve, and the adjustment was offset by related ADIT balances. The AG states that other ADIT related issues were addressed in Docket No. 12-0001 involving deferred compensation; plant additions; and Step-Up Basis Metro East. The AG asserts that all these issues ~~all~~ involved rate base assets that earn a return, and the ADIT balance associated with the asset was necessarily included in rate base to achieve the required consistency. Under the formula rate law, the under- or over-collection indicated by the reconciliation is not included as a rate base item, but the utility can recover interest at a rate equal to the WACC. In order to be consistent with standard regulatory practice that "matches" ADIT elements to the associated assets included in rate base, the AG asserts that the effect of deferred taxes on the under- or over-collection indicated by the reconciliation balance subject to interest must be recognized.

AG witness Brosch testified that applying interest to an adjusted under- or over-collections to reflect the income tax effect is also completely consistent with Generally Accepted Accounting Principles ("GAAP") procedures and rules. Under GAAP accounting rules, the

AG states that if there is an under-collection of revenues, the utility is required to record a deferred income tax expense related to the reconciliation balance because it is able to defer the payment of income taxes while awaiting recovery of reconciliation revenues. These deferrals of income tax expense have the effect of reducing the amount of capital the utility must carry in support of the under-collected reconciliation revenue requirement. The AG indicates that full and complete accounting for income tax expenses recognizes that income taxes have a major impact on revenues booked and expenses payable in more than one accounting period.

The AG ~~opines~~ states that the delayed collection (or refund) of reconciliation revenues under formula ratemaking creates a "taxable temporary difference" under GAAP rules, which occurs because the utility pays taxes on revenues actually received in the RY rather than on the revenue level indicated in the reconciliation revenue requirement and balance. The AG notes that AIC agrees that reconciliation revenues are recorded as per book revenues in the RY (either as excess or deficiency revenues) but these revenues will not become income taxable until the year they are charged or credited to ratepayers.

AIC witnesses argued that the fact that the utility does not pay taxes until it receives the associated revenues does not provide the utility with cash, which the AG believes ignores the effect of the timing of the payment of income taxes. The AG argues that changes in ADIT provide incremental cash flows to utilities through the change in timing of the payment of cash income taxes associated with such tax deferrals, and suggest that the essential purpose of deferred taxes is to provide the taxpayer with low-cost or no-cost capital by allowing the taxpayer to retain cash that otherwise would have been paid in taxes. The AG states that the statute indicates that interest is to be applied to "the under- or over-collection indicated by the reconciliation" so that the utility's actual costs are covered. Because the utility's actual cost is affected by income taxes, the AG

asserts it is necessary to incorporate the effect of income taxes so that interest is only applied to the net-of-tax over- and under-collections.

The AG notes that AIC Ex. 2.4, Schedule FR A-4 contains the data for the reconciliation computation, including the application of interest to the under- or over-collection indicated by the reconciliation. While the question of which provisions, schedules, and appendices of Exhibit 2.4 require a Section 9-201 action to be changed and which do not, will be addressed after the expected order in this docket, the AG proposes various changes to Schedule FR A-4 without waiving any arguments or positions about whether this change in fact requires a change in the formula rate structure or protocols. The AG details in its brief the manner in which it believes Schedule FR A-4, Reconciliation Computation, should be amended so as to incorporate this proposal, as well as attaching its proposed new schedule as Exhibit 2 to its Initial Brief.

The AG notes that in its Initial Brief, AIC first refers to the language of the statute 16-108.5(d)(1) of the Act and suggests that the precise mechanics of the reconciliation charge with interest are found in that section. The AG believes that a review of this language, however, shows that it is far from precise, noting that 16-108.5(d)(1) limits the interest charge to the "over-collection or under-collection" of an amount "indicated by such reconciliation." Although it could have, the AG submits that the statute does not provide that the full reconciliation balance shall be subject to interest or specify the mechanics of how the over-collection or under-collection amount is to be qualified.

The AG argues that implementation of this provision requires the Commission to analyze and determine the amount of money that represents the "over-collection or under-collection indicated by such reconciliation" because the statute does not say that interest is applied to the entire reconciliation balance. The AG submits that analysis

requires the Commission to evaluate the over-collection or under-collection under established regulatory principles.

The AG opines that the precise mechanics for assessing the over- or under-collection must refer to regulatory and evidentiary standards concerning prudence and reasonableness, and suggests that both the Commission and Illinois courts recognize that ADIT quantifies the income taxes that are deferred when the tax law provides for deductions with respect to an item, in a year other than the year in which the item is treated as an expense for financial reporting purposes.

The AG asserts that ~~while the over- or under-collection amount arising from the reconciliation is not in rate base, the interest provision is intended to compensate the utility for the financing costs associated with the fact that some portion of its costs are recovered as taxable revenues (or returned in the case of over-recoveries) in a subsequent year. The AG believes that~~ if utility income tax payments are reduced due to delayed recovery or return of reconciliation revenues, because of deferred income taxes, it is unreasonable to ignore the tax deferral impacts upon the net cash flow amounts indicated by the reconciliation that is actually under- or over-collected.

While the AG agrees with AIC when it notes in its Initial Brief that the EIMA is a highly specific law, the AG does not believe that means every detail of ratemaking is specified conclusively in the statute. While AIC argues that the over-or under-collection of revenues indicated by the reconciliation is the difference between the revenue requirement that was in effect for the prior rate year and the actual revenue requirement for the prior year, the AG contends this ignores the actual net-of-income tax cash flows arising from such reconciliation. Under these circumstances, the AG submits that AIC should not be made to pay interest on the full reconciliation amount, but rather should pay interest to ratepayers only on the excessive cash revenue amount collected, reduced by the corresponding

cash required for earlier payment of income taxes. The AG does not believe that the absence of a specific reference to taxes in connection with the over-collection or under-collection indicated by such reconciliation ~~does not~~ means that the effect of taxes should be ignored.

While AIC also argues in its Initial Brief that applying the statutory interest rate to the net-of-tax over- or under- collection effectively reduces the statutory interest rate, the AG suggests that this argument simply ignores the substance of a proposal and focuses instead on whether it can be expected to increase or decrease AIC revenues as the AIC's investments increase. The AG suggests that calculating the reconciliation over-or under-collection on a net cash flow basis properly recognizes that the utility will only avoid or incur interest expense on the net-of- tax over- or under-collection, which does not change the applicable interest rate.

On page 26 of the Int. Proposed Order, the final paragraph of the conclusion should be changed as follows, as indicated by the following inserts that are underlined, and deletions, indicated by ~~strikethrough~~:

5. Commission Conclusion

The Commission believes that both AIC and Staff have incorrectly interpreted the statute on this issue. The Commission notes that the EIMA is a statute which uses very specific language when discussing issues, but it does not address taxes one way or the other in connection with the reconciliation over- or under-collection. While EIMA establishes many unique regulatory procedures and requirements, it also directs the Commission to "apply the same evidentiary standards, including but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility… as it would apply in a hearing to review a filing for a general increase in rates under Article IX of this Act."220 ILCS 5/16-108.5(d)(3); see also *id*. at 16-

108.5(c)(1) & (6). We conclude that ~~and~~ if it had been the legislature's intent, the reconciliation language could have been drawn to indicate that ADIT would not have been a component of the calculation for any under- or over-collections.

The Commission also notes that in its order in Docket 11-0721, it rejected the AG's proposal on this issue, but based its conclusion on the paucity of record evidence. In this docket, the Commission is convinced that generally accepted accounting practices, regulatory principles, and fairness require that it not require consumers to pay Ameren interest on costs that the Company does not pay until the revenues are actually received. The Commission will therefore ~~decline to~~ adopt the AG's proposal for this issue.

C. The Proposed Interim Order Erroneously Accepts Groundless Objections Offered by the Company to the People's Proposed Depreciation Rate Adjustment.

In its August 19, 2013 tariff filing, the Company proposed modifying Schedule FR C-2 of its formula rate tariff to implement an adjustment to its forecasted depreciation expense, as more fully described in the People's Corrected Initial Brief at 24-27. In their Corrected Initial Brief and Reply Brief, the People demonstrated how the derivation of the proposed adjustment is not made clear in the Company's schedules, appendices, or workpapers, and the People proposed (People's Corr. Ini. Br. at 30-31) modifying the Company's proposed change to Schedule FR C-2, as well as the supporting Workpaper 18[4], to make the depreciation adjustment to both prior-year plant and projected plant additions more transparent, as required by Section 16-108.5(c) of the PUA.

[4] At Page 31 of their Corrected Initial Brief, the People also proposed modifying Workpaper 18 to clearly explicate the depreciation-related adjustment to ADIT found on Line 40a on of the Company's Schedule FR B-1 in its August 19, 2013 tariff filing.

The People support the ALJs' recognition of the utmost importance of both "AIC's efforts to bring clarity to the schedules and workpapers provided in these dockets" and "AIC's attempts to ensure that the documents provided assist in the understanding of each proceeding" with respect to the depreciation adjustment in the August 19, 2013 tariff filing. Int. Proposed Order at 31. However, the Int. Proposed Order declines to adopt the language offered by the AG "in light of the concerns expressed by AIC." *Id.* However, the Company's concerns, particularly those expressed in its Reply Brief, are completely unfounded and should not be used as a basis for the Commission's conclusions on this issue.

First, the Int. Proposed Order refers to a statement in the Company's Reply Brief that "there appears to be a mathematical error in the language offered by the AG which would not offer the clarity which the AG supports." The referenced line in the Company's Reply Brief states at page 15 that "[t]he AG seeks to insert a new Line 1a, which will represent a percent value for the adjustment to forecasted depreciation on plant," referring to page 30 of the People's Corrected Initial Brief. Turning to the aforesaid page 30, the People recommended inserting a new Line 1a on Sch. FR C-2 labeled, in Column A, "Adjustment to Forecasted Depreciation on Plant for Study-Based Change to Depreciation Rate," and they advocated that "the data for this adjustment should be calculated as indicated by the caption." Forecasted depreciation is ordinarily expressed in dollars, so the obvious inference is that an adjustment to forecasted depreciation would be in terms of dollars.

The Int. Proposed Order's rejection of the People's position is based on the Company's misrepresentation of the People's proposal. The People agree that reading this recommendation as calling for an adjustment in terms of percentage would indeed lead to difficulties, but the idea of presenting the adjustment as a percentage was never broached in any way by the People. In

case this was not clear, the People's Reply Brief stated expressly, in boldface and italicized font, at page 23 that their proposed new Lines 1a and 8a on Schedule FR C-2 would show adjustments to projected filing-year depreciation ***in terms of dollars***. Absent this alleged (and unfounded) complication with the People's proposal, the Company did not give any reason in its Reply Brief why adopting the People's proposed modification to Sch. FR C-2 would be difficult or inappropriate. The People simply propose that the underlying calculations (which the Company has already prepared, as shown in the data request responses reproduced at AG Exhibit 6.2) be presented visually in a more readily understandable fashion.

The Company also lamented in its Reply Brief at page 14 that the People's proposed modifications to Sch. FR C-2 contemplated only changes to the depreciation accrual rate based on an outside consultant's study and included no "discussion of changes to depreciation rates not based on a study." Indeed, the possibility that changes to depreciation rates will be based on something other than a study is belied by Company witness Stafford's response on cross examination that: "depreciation rates are conducted approximately every five years, so the only time that you would see an adjustment would be at the time of the new depreciation study." AG Ex. 6.0 at 49 (Docket 13-0301 Tr. at 269:2-5). If the Company's position is that the only time an adjustment appears is at the time of a depreciation accrual study, it is difficult to understand why Schedule FR C-2 needs to contemplate any other reason for a depreciation rate adjustment. Additionally, any time an electric utility seeks to change its depreciation rates, it must include a certification by an independent certified public accountant[5] that the new rates are consistent with

[5] In the instant proceeding, it is not clear that the Company has presented the required certification by an independent certified public accountant. Its depreciation accrual study reproduced at AG Ex. 6.1 was conducted by Gannett Fleming, Inc., which is an "international planning, design, and construction management firm" (http://www.gannettfleming.com, last accessed November 13, 2013), and was signed on Page ii (the second page of the exhibit) by John F. Wiedmayer, who does not appear to have a CPA designation (http://www.equitablegas.com/docs/pdf/rateCases/10_JFWiedmayer.pdf, last accessed November 13, 2013).

generally accepted accounting principles. 220 ILCS 5/5-104(c).[6] Thus, it is hard to see how depreciation rates might be changed without an outside study.

The Company also complained at page 14 of its Reply Brief that the People's proposals were not presented in expert witness testimony sponsored by the People. Two recently-litigated motions to strike (and their responses and replies) in Docket No. 13-0301 among the Company, the People, and the ICC Staff discussed this issue in greater depth, but the Commission should be very wary of a suggestion that a party be barred from arguing the application of the law to the facts or presenting a proposal in a litigated case if not already presented by experts in direct testimony. While analyses and opinions offered by expert witnesses form the basis of adjustments made by the Commission in rate cases, "[t]he trier of fact is not bound to accept the opinion of an expert on an ultimate issue." *In re Marriage of Gambla and Woodson*, 367 Ill.App.3d 441, 468 (2nd Dist. 2006); *People v. Campos*, 227 Ill.App.3d 434, 448 (1st Dist. 1992) ("[t]he rationale behind allowing such expert testimony as to ultimate issues is that the jury is not required to accept the opinion"); *Zavala v. Powermatic , Inc.*, 167 Ill.2d 542, 545 (1995) ("the trier of fact is not required to accept the expert's conclusion"). Under the Company's view of Commission ratemaking proceedings, the Commission would be required to limit its review of adjustments to the precise justifications and analyses offered by expert witnesses and ignore the legal implications of the adjustments. Illinois law rejects this notion.

The Company's attempt to dismiss the People's arguments should further be rejected because expertise is not needed to examine Schedule FR C-2 in the Company's August 19, 2013 tariff filing (AIC Ex. 2.5, part of the record evidence, in this proceeding), note that the Line 8a "adjustment" is sourced to Workpaper 18, then turn to Workpaper 18 (pages 16-26 of AIC Ex.

[6] Also, new depreciation rates set pursuant to § 5-104(c) of the PUA may nonetheless be set aside by the Commission in a subsequent rate proceeding. 220 ILCS 5/5-104(d).

18.4, part of the record evidence, in Docket No. 13-0301) and notice that the adjustment is not calculated there. An attorney can and should note, without asking experts, that the Company's proposed depreciation rate adjustment in its August 19, 2013 tariff filing is not transparent, in contravention of the § 16-108.5(c) requirement. More generally, many intervenor parties, including the People, have limited budgets to engage experts; parties should not be precluded from proposing modifications to a utility company's filing, based on a failure of the record evidence to conform to statutory requirements, irrespective of whether they have sponsored expert testimony on the issue.

The Agreed Joint Motion to Consolidate filed on September 18, 2013 in Docket Nos. 13-0501, 13-0517, and 13-0301 provided at ¶¶ 3-4 on pages 11-12 that all template modifications proposed by any party in any of those dockets prior to the Agreed Joint Motion would be potentially contestable in the newly consolidated docket, leading to an order on or before November 27, 2013 addressing all such issues. The Agreed Joint Motion provided at ¶ 11 that the Joint Movants (the ICC Staff, the People, and the Company) could introduce only testimony transferred from Docket No. 13-0301, rather than generating new expert testimony. However, the Agreed Joint Motion did not provide that the Company's August 19, 2013 tariff proposals in Docket No. 13-0517 could only be challenged by proposals made in Docket No. 13-0301 rebuttal testimony; given the nearly impossible timeline[7] resulting from the August 19 filing, the People never would have agreed to such a restriction. The Company's position is apparently that, if a party did not incorporate into its Docket No. 13-0301 rebuttal testimony commentary on a component of the August 19, 2013 tariff filing during the three business days the party had

[7] The Company served the August 19 tariff filing upon the People on Wednesday, August 21, and intervenors' rebuttal testimony in Docket No. 13-0301 was due on Monday, August 26.

access to the filing, that component is now impregnable to challenge in this consolidated docket. The Company may prefer this arrangement, but no other party ever agreed to it.

The Commission should reject the Company's suggestion that it ignore the People's recommendation that the schedules, appendices, and workpapers should clearly illustrate the calculation of depreciation changes. While Company witness Stafford previewed the adjustment in his rebuttal testimony filed July 29, 2013, which stated that the filing-year depreciation expense adjustment "would require the addition of three lines on App 8 and a source reference modification to Sch. FR C-2" (AIC Ex. 9.0 at 9:201-204), the actual changes proposed by the Company in its August 19, 2013 tariff filing were very different. In fact, the Company inserted only *one* new line – to Sch. FR C-2 and nothing on Appendix 8 – to reflect the depreciation rate change and did not modify Appendix 8. Docket No. 13-0517, Suspended Tariff, Appendix B, Page 2 (August 19, 2013). The implementation of the proposed depreciation rate adjustment on the August 19, 2013 tariff filing was at odds with Mr. Stafford's previous description of the adjustment and caught the People by surprise, to say the least. Given the visual organization of Schedule FR C-2, more than one new line should be inserted if forecasted depreciation on both existing plant and projected plant additions are being adjusted. More importantly, however, the changes to the tariff schedules and appendices are plain on the face of the documents, and the conclusion that they do not accurately or specifically refer to the source calculations does not require expert analysis or testimony.

PROPOSED LANGUAGE:

On page 31 of the Int. Proposed Order, the final paragraph of the Commission's conclusion should be altered as follows, as indicated by the following inserts that are <u>underlined</u>, and deletions, indicated by ~~strikethrough~~:

> The Commission believes that based on the evidence presented in the record in this docket, that the proposal offered by Staff, supported by AIC and CUB, and partially supported by the AG, is appropriate and therefore it will be adopted in this proceeding, subject to the modifications offered by the AG. ~~The Commission finds that it is unable to adopt the language offered by the AG, in light of the concerns expressed by AIC.~~ The Commission ~~does~~ is encouraged by AIC's efforts to bring clarity to the schedules and workpapers provided in these dockets., ~~and will therefore encourage~~ To further the goal of clarity, the Commission directs AIC to ~~study~~ adopt the proposal offered by the AG at pages 30-31 of its Corrected Initial Brief and Exhibit 3 thereto, so that the amount by which the depreciation expense is changed in the event of a changed depreciation rate is clearly presented and calculated in the formula rate template and its workpapers. ~~as AIC's attempts to ensure that the documents provided assist in the understanding of each proceeding.~~

E. The Proposed Order Correctly Adopts the People's Proposal on Income Tax Expense Lead for Cash Working Capital Calculation.

The Int. Proposed Order at 40 correctly acknowledges that "We have always done it this way" is not sufficient justification to allow the continued use of an accounting treatment at odds with prudent accounting practice, statutory standards, and basic logic. If the Company is not paying any cash income tax in a given year, no cash working capital should be allotted for income tax payment in that year. The People support the ALJs' decision to adopt their proposal.

PROPOSED LANGUAGE:

On page 40 of the Int. Proposed Order, the final paragraph of the Commission's conclusion should be altered as follows, as indicated by the following inserts that are underlined:

> In reviewing the arguments on this issue, the position of AIC and Staff can be best summarized as "we have always done it this way, why change now?" In response, the AG and CUB offer valid reasons for reconsidering this practice. No party disputes that AIC will not actually pay any income taxes until 2015, yet AIC would have its ratepayers contribute to CWC as if it were paying income taxes now.

> Under similar income tax circumstances, ComEd ratepayers do not contribute to CWC. Why this disparate treatment of ratepayers should be allowed to continue has not been justified by AIC or Staff. "We have always done it this way," without more, is no justification. Logic and fairness to ratepayers compel the Commission to adopt the AG's position on this issue. The Commission directs the Company to modify Appendix 3 of its formula rate tariff to exclude deferred income tax from the cash working capital calculation, as shown on Exhibit 5 to the People's Corrected Initial Brief.

IV. CONCLUSION

WHEREFORE, the People of the State of Illinois respectfully request that the Commission enter a final order consistent with the recommendations made in this Brief.

Respectfully submitted,

The People of the State of Illinois

By LISA MADIGAN, Attorney General

_____/s_____

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